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GENE KIMMELMAN

Co-Director
Washington Office
Consumers Union

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On

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> By now, and certainly by 2004, AT&T as well as the company once called MCI and perhaps even Sprint, were expected to be significant forces in local communications markets across the country. New communications companies, lots of them, were supposed to be bringing smiles to both investors and consumers by delivering innovative bundles of services, worrying the old carriers and stealing their customers. Many people thought that cable companies would be offering local phone service broadly, even as phone companies would be offering television service, adding choices and driving down prices in both markets. The Internet, or at least wireless technology, was supposed to threaten the traditional telecommunications oligopolists with irrelevance.
>
> Consumers were supposed to be able to choose from many new local carriers, leading to better service and lower prices.
> Little of that has happened. The Bells – the race's tortoises – have won…
> .
> ********
> The local phone companies have networks that cannot be duplicated. That is why, lawmakers' rhetoric aside, unfettered deregulation will not lead to more competition. If competition and lower prices are the goal, pro-competition oversight is required to ensure that the companies with essential assets do not use them to stifle others.[1]

Unfortunately for consumers, this quotation from the New York Times accurately describes how the 1996 Telecommunications Act's goal of promoting broad-based local telephone competition has failed to become a reality. Consumers Union[2] and the Consumer Federation of America[3] believe that, if Congress remains committed to expanding telecommunications choices and lowering prices for consumers, significant

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[1] Seth Schiesel, "Sitting Pretty: How Baby Bells May Conquer Their World," <u>New York Times</u> April 22, 2001.

[2] Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about goods, services, health, and personal finance. Consumers Union's income is solely derived from the sale of *Consumer Reports*, its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, *Consumer Reports* with approximately 4.5 million paid circulation, regularly carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions that affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

[3] The Consumer Federation of America is the nation's largest consumer advocacy group, composed of over 280 state and local affiliates representing consumer, senior, citizen, low-income, labor, farm, public power an cooperative organizations, with more than 50 million individual members.

regulatory oversight for a considerable period of time will be necessary. The attached Appendix A entitled "The Status of Residential Local Telephone Competition," describes in detail how we got to this market and regulatory situation.

More than five years of experience under the Act illustrates how deregulating entry into local telephony does not do nearly enough to open that market to competitive forces. You will recall that, in preparation of the Act, cable television industry representatives unequivocally told this Committee that "…cable television companies are the most likely competitors to local phone monopolies…" and asserted that eliminating cable rate regulation would make that competition happen:

> If you look at the entire structure, the competitive theory of the broad legislation in front of this committee, the theory is that you are going to allow the Regional Bell companies to move into manufacturing, information services, burglar alarm services, cable, other areas, and that their potential for anticompetitive behavior is going to be checked because they are going to have competition. And then you look around, and who is going to prove that competition?
>
> And I would submit to this committee it is us. We are the other wire, and if we do not have the financial and investment environment to make those investments, those tens of billions of dollars, then the end result is that this committee and this Congress will have opened up a Pandora's box in terms of extending the regional phone companies' monopolies, and you will never close it again. [4]

While the cable industry has invested billions since the Act phased out cable rate regulation, industry revenue has increased by more than $14 billion per year,[5] rates are up nearly 34%[6] but less than one percent of consumers receive local phone service over a cable wire (see Appendix A at 6). Wireless is not a substitute for local phone, because it

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[4] Statement of Decker Anstrom, National Cable Television Association Before the Committee on Commerce, Science, and Transportation, U.S. Senate, Mar. 21, 1995, S. Hrg. 104-216.
[5] In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, CS Docket No. 00-132, Seventh Annual Report, January 8, 2001, pg 102.

is not flat rate and because it is significantly more expensive for the same amount of usage. Other technologies that were supposed to obliterate the local phone monopoly have not materialized. In other words, the dream of wire-to-wire or other facilities-based competition has failed abysmally.

Some have argued that flash-cut Bell entry into long distance (or data long distance) will spur retaliatory local facilities investment from long distance companies. They believe that these companies are hiding behind regulatory "transition" mechanisms designed to open the door to local competition, which in reality allow the long distance carriers to slow-roll investment in local facilities. However appropriate this skeptical attitude was a number of years ago, it makes no sense in today's economic climate.

It now appears that not only small competitive carriers, but the likes of Sprint, Worldcom and AT&T long distance are either on the ropes financially or likely to be taken over by one of the large local phone companies.[7] So long as the high costs and technical problems related to cable, wireless, Internet telephony or other technologies persist, the only way to sustain potential facilities competitors is to prohibit Bell entry into long distance until competitors are able to use the Bell infrastructure in approximately the same manner and under the same financial conditions as the Bell company itself.

As we point out in Appendix A, so long as the Federal Communications Commission (FCC) and state regulators pursue rigorous oversight of the Bell companies' pricing and market-opening practices, there is some chance that consumers will receive the benefits

[6] Bureau of Labor and Statistics, Consumer Price Index for Cable, May 2001.

of local telephone competition promised in the 1996 Act. If the careful oversight of Bell practices initiated and ongoing in New York were the norm in other states considering Bell entry this year, we estimate that consumers could save as much as about $7 billion a year on their local and long distance calling (see Appendix A at 15). In New York this rigorous oversight and fact checking has translated into local and long distance price reductions ranging from 5 to 20 percent (see Appendix A at 13).

Of course, the New York process involves considerable regulation of Bell company facilities, enabling competitors to take advantage of a monopoly infrastructure to jump-start retail competition. Will this lead to full-blown facilities build out and broad based competition? We do not know. However, if Congress believes the "cost" associated with this ongoing regulation of the Bell companies is too severe, we urge you to consider the alternatives.

Relaxing regulation of the Bell company infrastructure is likely to lead to the demise (or consolidation) of the major residential long distance and small local phone competitors. While Verizon in New York, and SBC in Texas, entered the long distance market offering significant long distance savings – up to 50% for low volume consumers – (see Appendix A at 15) it is extremely unlikely that these savings would exist in a significantly less competitive long distance market. In fact, in states where non-Bell local phone companies have entered the long distance business, without the market-opening obligations that the 1996 Act imposed on the Bell companies, long distance companies have lost substantial market share to local carriers that did not need to

[7] Legg Mason, "The Coming Communications Consolidations,"" June 2001.

discount their rates at all (see Appendix A at 16). If the Bell companies end up dominating both the local and long distance residential markets, Congress will face the need to impose a much more extensive regulatory oversight model than currently exists, to prevent local and long distance price gouging.

Unfortunately, in this economic environment, we find no “silver bullet” to deliver local phone competition through multiple facilities to consumers in the foreseeable future. We therefore believe Congress should direct the FCC and urge the states to follow the paths of New York and Texas, using careful regulatory oversight to at least test the notion that non-discriminatory sharing of local monopoly infrastructure can ultimately lead to full-blown facilities competition.

Appendix A

THE STATUS OF RESIDENTIAL LOCAL TELEPHONE COMPETITION

Prepared by

Dr. Mark Cooper
Research Director
Consumer Federation of America

JUNE 2001

I. THE FAILURE OF LOCAL COMPETITION

A. The Paradox of a "Level Playing Field" and One Hundred Years of Government-Sanctioned Monopoly – Why Facilities Based Competition Does Not Exist

The central public policy embraced by the 1996 Telecommunications Act was the introduction of competition into all telecommunications markets in a measured and structured fashion. Congress recognized that the most difficult area to accomplish this goal was in the local exchange market of the monopoly Regional Bell Operating Companies (RBOCs, also known as the Bells). The insurmountable barrier to entry in this market has been the paradox of attempting to create a "level playing field" when the incumbent leader has enjoyed nearly one hundred years of government-sanctioned monopoly as well as seven decades of public policy and subsidies directed at making that company's network ubiquitous.[i]

It is also important to remember that the Bell System ran afoul of the antitrust laws. In settling a decade long antitrust case against the Bell system with the 1984 Modification of Final Judgment (MFJ), these companies agreed to stay out of long distance services in markets where they had local monopolies. They agreed to be subject to very demanding antitrust tests should they seek to provide long distance to their local customers.

When Congress stepped in to replace the MFJ, it laid out an elaborate plan for opening the markets of all local exchange companies (LECs) (in sections 251, 252 and 253 of the Act). In the case of the RBOCs, Congress required that they meet a specific set of additional conditions in the local market before they are allowed to sell long distance (InterLATA) service to their home territory customers (in Sections 271 and 272 of the Act).[ii]

Reflecting the more highly developed level of competition in the long distance industry and the fact that local exchange markets are a bottleneck input for long distance markets, Congress placed its emphasis on ensuring that local markets would be competitive. While today's long distance oligopoly could be expected to perform better if greater competitive forces were brought to bear in it, the crucial barrier to competition in the telecommunications industry is the local monopoly.[iii]

More than five years after the passage of the 1996 Act, it is evident that those Congressional concerns were well founded. Predictably the incumbent monopolists resisted opening their markets to competition, while they sought to get into long distance as soon as possible. The campaign to get into long distance without opening their local markets started with a constitutional challenge to the section that required them to open their local markets. Failing that, they repeatedly filed applications to enter long distance markets before coming near to treating competitors at parity with their own operations for the critical functions of ordering and billing, installation and repair and, above all, in pricing elements of the network.

Prospects for facilities-based, wire-to-wire competition—the promise that led many legislators to support the 1996 Act to the public—are dim at best.[iv] The industrial organization and regulatory oversight of the communications industry are a shambles from the point of view of competition for residential consumers.[v] Across the nation, new entrants to the local phone market have been unable to crack the local telephone monopoly to any significant extent. Competitive local exchange carriers (CLECs) have captured about 8 percent of the total local lines in the country, but for residential and small business consumers the figure is about 4 percent.[vi] Worse still, most of this competition is not with new wires. Wire-to-wire competition accounts for only about 1 percent of the total number of lines nationwide and in the residential and small business sector, it is less than one percent.[vii] In other words, the incumbent monopolists still have a complete stranglehold on local telephone wires.

In addition to the shelter afforded the Bells by the immense costs of building an entirely new network, the Bells have protected their local monopolies with more overt anticompetitive practices, such as by promoting legislation against building new networks. For example, Bristol, a rural Virginia town, saw that a high-speed network would help spur development in their area and realized that the Bell company serving them was not likely to provide it to their community (because they were either too remote or had demographics that did not support the case for the Bells to build a network in their area). They chose to build a municipal high-speed network, but in response, Verizon successfully lobbied the state legislature to pass a law that prevented municipalities from building such networks. Such laws have been passed at the Bells behest in nine states.[viii]

The failure of new entrants to break the monopoly of the incumbents is reinforced by the failure of incumbents to compete against one another. It was hoped that the large incumbent local monopoly companies might attack their neighbors' service areas, as they are the best situated to do so. But such competition has not happened.[ix] The incumbent local exchange carriers (ILECs) have simply not tried to enter each other's service territories in any significant way. In fact, they have done quite the opposite. Rather than compete, they have merged. Before the 1996 Act was passed, the largest four ILECs owned less than half (48%) of all the lines in the country.[x] Today, the largest four local telephone companies —Verizon (made up of NYNEX, Bell Atlantic and GTE), SBC (made up of Southwestern Bell Telephone, PacTel, Southern New England Telephone, and Ameritech), BellSouth and Qwest— own about 85% of all the telephone lines in the country.[xi]

Ironically, although the market power of the incumbent local exchange companies has not been significantly reduced, at his first press conference as Chairman of the Federal Communications Commission (FCC) Michael Powell made the striking statement that "deregulation is not like dessert," suggesting that deregulation should come before competition is established.[xii] The Bells have redoubled their efforts to cut back on obligations to open their markets.[xiii]

B. Wooing the Bells into Opening Their Local Markets Has Not Worked – The Failure of § 271

1) The Design of § 271

Regardless of his personal preferences, as Chairman of the FCC, Mr. Powell is duty bound to enforce the Telecommunications Act of 1996 (the Act or the 1996 Act), which does not take that point of view.[xiv] The provisions of §271 seek to redress the imbalance of market power between local companies and their potential competitors.[xv] The Department of Justice and the FCC adopted a common sense approach to the implementation of the Act. At least until recently, these agencies have insisted that meaningful local competition actually exists as the standard for a central component of the §271 approval process. The Department of Justice has also pointed out that the failure of competition to spread beyond a very small number of select markets is a concern. The FCC has noted that it was this competitive imbalance that Congress sought to address in §271.

> By requiring BOCs to demonstrate that they have opened their local markets to competition before they are authorized to enter into the in-region long distance market, the 1996 act enhances competition in both the local and long distance markets.
>
> If the local market is not open to competition, the incumbent will not face serious competitive pressure from new entrants, such as the major interexchange carriers. In other words, the situation would be largely unchanged from what prevailed before the 1996 act. That is why we must ensure that, as required by the Act, a BOC has fully complied with the competitive checklist. Through the competitive checklist and the other requirements of section 271, Congress has prescribed a mechanism by which the BOC may enter the in-region

> long distance market. This mechanism replaces the structural approach that was contained in the MFJ by which BOCs were precluded from participating in that market.[xvi]
>
> Without §271, there was little in the Act to give the BOCs incentives to open their markets.[xvii]

Congress was not satisfied that the general requirements placed on the local exchange companies to open their networks to competition would be effective in the case of the RBOCs because of their dominant position and history of abuse of monopoly. Congress required additional conditions and oversight by other agencies before the RBOCs would be allowed to sell in-region long distance. Congress required the FCC to make findings in four areas before RBOCs were to be allowed into in-region long distances.

Part III of the Act, "Entitled Special Provisions Concerning Bell Operative Companies," which includes section 271, deals almost entirely with the additional steps Bell Companies must take in opening their markets before they are allowed into in-region long distance. Together Section 271 and 272 includes a number of conditions

- a requirement that actual, facilities-based competition for both business and residential customers exist within a state;
- a checklist of 14 technical conditions and services that had to be provided to competitors on rates, terms and conditions that are just, reasonable and nondiscriminatory;
- safeguards to prevent abuse of transactions between local companies and their affiliates; and
- satisfaction of a public interest test.

These findings were to be made in consultation with the states and the Department of Justice (whose advice was to be given substantial weight).[xviii]

2) Resistance from the Bells to Opening Their Local Networks

a) Verizon

It took more than two years after the Telecom Act became law before any of the Bells would accept the fact that they were going to have to open their markets. Verizon in New York (originally NYNEX and later Bell Atlantic) finally agreed to take the necessary steps to open its local market in its "Prefiling Statement." [xix] This document, negotiated between the New York Public Service Commission, the DOJ and Verizon, outlined the steps necessary to achieve legitimate market opening.

The prefiling statement did not end resistance to market opening, even for Verizon. Verizon continued its strategy of resisting opening while insisting it should be allowed into long distance. It delayed implementing tariffs for months, thereby denying entrants access to the market opening measures to which it had agreed. The test of operating support systems (OSS) had not even started, but it repeatedly declared that it would immediately apply for entry when the test was complete. These tactics of delay cast serious doubt on Verizon's ability to pass the public interest test of market opening. By restricting the availability of the market-opening measures, those markets that were least developed were retarded the most—upstate and residential markets.

Resistance to market opening also continued in other states. When the Chairman of the New York PSC endorsed the prefiling statement, he noted four key elements of the agreement as indicators of the progress that had been made. Unfortunately, when Verizon was asked to adopt the same conditions in Pennsylvania, it refused to commit to implementing every major market opening concession. [xx] The repudiation of the New York roadmap by Verizon-PA is stunning. Verizon has taken essentially the same approach in New Jersey. [xxi]

Verizon's lack of good faith in extending the New York approach to other locations and its continued devotion to getting away with anything it can was demonstrated when it filed its application in Massachusetts. It filed an initial application based on unbundled network element (UNE, described in detail below) prices that were completely unjustified – as much as $20 per month for usage.[xxii] Faced with certain denial, it threw in unbundled network element prices from another state, which, themselves, were based on a methodology that has been demonstrated to be faulty.[xxiii] Instead of presenting the Commission with legitimate, reasonable and efficient rates from Massachusetts, it threw in old rates from New York, which the New York Commission had already begun to revamp.

Verizon used a similarly flawed application in Pennsylvania. After years of litigation the Pennsylvania Commission was severely divided over whether Verizon had complied with the Act. In other words, three years after making the open market commitment in New York and a year and a half after being granted entry in New York, two of the five Commissioners in Pennsylvania were still not convinced the market has been opened in their state.[xxiv]

b) SBC

SBC was the second company to gain entry into long distance, starting in its flagship state, Texas. In a pattern similar to New York, after months of collaboration, the Texas Public Utility Commission found 129 things that SBC had not yet done to open its markets. SBC resisted, but when the commission held its ground, it took another two years to get the application in order. Moreover, agreeing to open the Texas market did not ensure other markets would be opened rapidly. SBC continues to drag its feet in its other states, trying to gain entry with applications that fall far short of what was done in Texas.

SBC has pushed forward a series of applications that fall considerably short of the Texas standard in a number of ways. SBC resists extending the same conditions to other states, until the last moment. After it agrees to implement similar conditions, it then seeks immediate entry, denying competitors an opportunity to establish business plans on the basis of a final set of conditions. As a result, SBC has gained entry under conditions that are much less conducive to competition than New York. Seriously flawed applications were given eleventh hour approval by the William Kennard-led FCC. There is growing evidence that the Kansas/Oklahoma applications were seriously flawed, in that they contained substantial misrepresentations, notwithstanding the fact that SBC has claimed those misrepresentations were accidental and inadvertent. SBC has recently withdrawn an equally flawed application in Missouri.

c) BellSouth and Qwest

BellSouth and Qwest (formerly U S WEST) have yet to have a request for entry into long distance approved in any of the states that they serve. Early on, BellSouth pressed several very premature applications, but was rebuffed. Its efforts currently are focused on Florida, North Carolina and Georgia.

Qwest appears to be the farthest aware from gaining entry, due to its failed attempts to explain Operating Support Systems (OSS, i.e. the systems that enable subscription, billing, installation, repair and customer transfer) problems for its competitors.

C. Alternative Technologies Have Failed to Provide Effective Competition for Local Phone Service

1) Cable Telephony Has Not Been Deployed at Promised or Significant Levels

Wire-to-wire competition has been a bust in another very evident way—the promise of alternative technologies such as cable telephony to deliver residential local phone competition has not been borne out by business reality. Where big cable companies once guaranteed they would deliver all communications and entertainment services on a single platform with a single bill, business reality intruded and they found it was more efficient and they could extract more value from consumers by offering distinct service offerings.

Throughout October 2000, AT&T conducted a flurry of board meetings, press conferences and conference calls with Wall Street analysts to explain its decision to break itself up into three companies.[xxv] The admission that its business strategy had failed was obviously bad news for AT&T stockholders, but it was even worse news for telephone consumers. It signaled the failure of the Telecommunications Act of 1996 to deliver local phone competition.

AT&T justified its purchases of cable TV companies to regulators and bankers by claiming that local telephone competition over cable wires could be provided only as part of an integrated package of voice, video and data services.[xxvi] It promised to use the tens of millions of cable lines it was buying to compete for local telephone service.[xxvii] Now AT&T is going in the opposite direction. The company is splitting the cable business from the telephone business from the wireless business, and creating a separate tracking stock for its consumer long distance business. The difficulties of providing switched telephone service over cable networks render such activity uneconomic.[xxviii] It appears that two separate networks, each optimized around very different functionalities, make perfect economic sense, for three reasons.[xxix]

1) Functional specialization (letting the network do one thing well rather than several things poorly) is a sound economic principle, especially when there are diseconomies of integration between switched (i.e. telephone) and non-switched (cable TV) services. At present, it costs too much to make one network do very different things.

2) "One-stop-shopping" sounded like a good idea but it was not compelling when one-click shopping is available for almost anything. Consumers are not clamoring for one huge package of voice, video and data services.

3) Business goal planning, setting and achieving is much more difficult. It is EXTREMELY challenging to sell three distinct services to very different kinds of customers.

Specialized networks that do not compete directly for their core businesses pose a problem for policymakers. Without wire-to-wire competition, the plain old problem of monopoly power in cable TV and local telephone networks still exists.[xxx]

2) Wireless Does Not Compete with Basic Service

Wireless telephone service technologies have not solved the problem of lack of competition for local service and will not solve it any time soon. Cellular phones have become popular, but this service has not emerged as a substitute for basic telephone service for several reasons.

1) Even though the price of wireless has come down, for the average consumer wireless costs about five times as much as local service.[xxxi] The average flat rate telephone is in use for local calling about 1300 minutes per month.[xxxii] The average monthly charge is about $20 per month. The average cost per minute of use is $.015. Assuming half the usage is outgoing, the cost per minute of a call made is $.03. This is much less than average cost of cellular calling plans, which run in the range of $.10 to $.15 per minute.

2) Cellular service is measured service; local exchange service is generally flat rate.

3) Cellular service does not allow multiple phone hookups on the same phone number, in contrast to wireline service.

4) Cellular charges not only for outgoing calls, but also for incoming calls, which is never the case with wireline service.

The proof that wireless and basic wireline services occupy different product spaces can be seen in the numbers of consumers subscribing to each. Both wireless and wireline have been growing at strong rates. In fact, since the 1996 Act was passed, the number of local access lines has grown faster than at any time since the 1984 break-up of the AT&T system. Local exchange revenues have been growing twice as fast as other wireline revenues, and faster than they had in the in the first half of the 1990s.[xxxiii] Thus, although cellular has achieved a high market penetration, it does not represent an economic substitute for wireline local telephone service.

D. Resale Markets Are Broken

Congress realized when it passed the 1996 Act that the Bell companies' near century of government sanctioned monopoly gave them a tremendous competitive advantage—it allowed them to build out a vast network without fear of a competitor coming in and forcing them to lower their prices—market conditions that cannot be replicated today. Accordingly, in addition to providing incentives for facilities-based competition, Congress provided for the resale of unbundled network elements (UNEs). That is, the piece parts of the local network must be made available to new entrants to create competition. However, the RBOCs have used a host of subtle and not-so-subtle tactics that have hampered the development of UNE resale. Making unbundled network elements (UNE) available on prices, terms and conditions that will support competition is the primary battleground at the public utility commissions in the year ahead. These UNEs were the central focus of the 14-point checklist.

Vendors need two things to succeed in the UNE market: operating support systems (OSS) that treat competitors equally and reasonable, cost–based prices for unbundled network elements. The subtext here is that competitors need certainty. By making life difficult for their competitors with respect to OSS and pricing, the Bells have been able to introduce market uncertainty that has made it nearly impossible for CLECs to raise needed funding in the capital markets. Faced with uncertainty, competitors find it extremely difficult to raise funds and make major commitments to invest in local competition.[xxxiv] Uncertainty is most likely to inhibit their entry into the less attractive markets.

1) Bells Leverage Operating Support Systems (OSS) to Their Competitors' Disadvantage

In order to win customers, competitors must be able to seamlessly transfer new subscribers from the incumbent. The Bells, through control of OSS, are able to block entry through institutionalized incompetence. The Bells refused to allow competitors to use their operating support systems to sign up customers. Instead they set out to develop new systems to give competitors access. They have been unable, or unwilling, to develop those systems to treat competitors equally.

It is critical for customers to be smoothly transferred when they decide to switch telephone companies. Consumers will not tolerate loss of service, misbilling, or being left out of customer databases because telephone service is too important for consumers to do without. Competitors have found that interfaces are not in place and have not even been tested in some instances. They are not automated, so that customers seeking to change service providers are forced to experience serious delays.[xxxv]

A recent *Wall Street Journal* article[xxxvi] noted that the FCC is investigating how SBC provided incorrect information regarding OSS to regulators who were considering allowing SBC into the long distance markets of several Southwestern states. Apparently, SBC knew for at least two years that when competitors tried to put in a help or repair request into its support system, they would receive an incorrect error message saying that the customer in question belonged to SBC (when the customer in fact belonged to the competitor). In order to process the order, the competitor would have to fax or phone in the repair request. While this may seem trivial with respect to any particular order, over the course of thousands of requests this could serve to practically shut down a competitor's operation.

While it is difficult to quantify the current level of OSS functioning across the nation, in a broadly comparative framework, it is clear that most of the large states that are being targeted for entry by the Bells (see Exhibit 1) have not satisfactorily solved the problem of providing non-discriminatory access to the business and technical features and functions necessary to allow competition.

2) Bells Charges for Unbundled Network Elements (UNE) Are Unfair and Anticompetitive in Many Cases

UNE pricing has been a second major leverage point for the Bells to block entry into their local markets. By including items in UNE prices that are unfair to competitors, those competitors are unable to squeak by on the thin margins offered by UNE resale. Establishing fair prices for competitors to use unbundled network elements has been a monumental struggle. Although the courts have upheld the FCC's decision requiring prices to be based on efficient, forward-looking costs, the final decision is pending a ruling by the Supreme Court. This resistance has resulted in protracted proceedings that have resulted in prices in many states that make competition impossible.

Assessing the current status of the pricing of unbundled network elements is a complex task. At the current stage of development, most competitors need to purchase a complete unbundled network element platform (UNE-P). This comprises the wires (loop), the port into which the wires are connected, local switching services, and transport of calls in the local area. The pricing of these four elements varies widely from state to state.

As a practical matter, in the large states identified in Exhibit 1, there is not a great deal of difference in the cost of the service or in the total revenue per line. In these states, when basic local rates, access revenues and additional features are included, telephone bills converge. However, Commissions have arrived at dramatically different prices even when there are not large differences in costs. This is especially true for the switching costs, which should not be subject to a great deal of variation.

EXHIBIT 1: COMPETITION, MARKET CHARACTERISTICS AND OBSTACLES

	COMPETITIVENESS INDICATORS				TELECOMMUNICATIONS MARKET CHARACTERISTICS					OBSTACLES TO COMPETITION
	Intensity	Extensiveness: Number of CLECs in zip code areas		Balance	% Res/ Small Business lines	TELRIC Cost (Loop + Port, per month	Household Income	Long Distance Calls (number per line per year)		
		6 or more	none					IntraLATA	InterLATA	
NY	1.00	1.00	1.00	1.00	66.19	$16.31	$37,390	31	583	
TX	0.41	1.03	0.44	0.22	80.95	$19.35	$35,780	32	317	
MA	0.31	0.51	0.64	0.27	63.57	$17.33	$42,350	138	485	PRICE, PREMATURE ENTRY
PA	0.29	0.38	0.22	0.24	69.67	$19.84	$39,020	108	539	OSS
IL	0.26	0.44	0.14	0.20	72.37	$17.10	$43,180	43	567	OSS
GA	0.23	0.85	1.00	0.09	84.46	$21.37	$38,660	61	522	OSS
CA	0.19	0.72	0.47	0.21	79.03	$16.77	$40,930	221	373	OSS, PRICE
CT	0.16	0.00	7.00	0.14	82.48	$22.47	$46,510	327	370	PREMATURE ENTRY
WA	0.15	0.18	0.24	0.12	74.22	$18.75	$47,420	80	452	OSS
AZ	0.15	0.00	0.16	0.24	76.59	$17.94	$37,090	31	490	OSS, PRICE
FL	0.12	1.23	1.17	0.06	81.55	$17.12	$34,910	44	497	OSS, PRICE
NJ	0.08	0.18	0.88	0.14	64.99	$17.28	$49,830	164	460	OSS, PRICE
MO	0.07	0.03	0.10	0.04	82.30	$22.09	$40,200	76	263	OSS, PRICE
OH	0.06	0.08	0.13	0.08	78.98	$18.74	$38,930	58	590	OSS
MD	0.04	0.33	0.19	0.06	61.75	$18.52	$50,020	46	637	OSS

Sources and Notes:

Competitiveness indicators are from Industry Analysis Division, Local Telephone Competition: Status as of December 31, 2000, May 2001, expressed as ratio compared to New York with New York set as 1 and then each state's performance

Intensity = % of residential & sm. business lines served by CLECs in state X / % residential & sm. business lines served by CLECs in NY

Extensiveness Competitors 6 or more = % of zip codes with 6 or more CLECs in state X / % of zip codes served by 6 or more CLECs in NY

Extensiveness Competitors none = 1/(% of zip codes with no CLECs in state X / % of zip codes with CLECs in NY)

Balance = 1/(ratio of lg business to residential & small business lines served by CLECs in state X / ratio of lg business to residential & small business lines served by CLECs in NY

TELRIC cost is from the FCC, Synthesis Proxy Cost Model; Household Income is from U.S. Bureau of the Census, *Statistical Abstract of the U.S.: 2000,* Table 724.

Long Distance Usage is from FCC, *Statistics of Common Carriers: 60th Anniversary Issue*, Tables 2.4 and 2.5.

In fact, in the past few months, the FCC and utility commissions in Illinois, Florida, Michigan and Pennsylvania, as well as an Administrative Law Judge in New York, have all pegged the cost of switching at a much lower level than had been the case. In these states, switching costs will be in the range of $2 to $3 per month for typical levels of local usage. New Jersey, California, Arizona, and Massachusetts have rates in place that would cost three to four times that much, $8 to $10 per month.

The pricing of other unbundled elements also remains a problem. In some states fixed monthly costs have been the problem. Very high charges for loop stand out in Arizona, Colorado and Louisiana. In other states, there are also very large differences for non-recurring charges.

There is no end of Bell shenanigans in UNE pricing. For instance, Verizon adds "Annual Cost Factors" into its loop rate, a 12% charge that includes the cost of Verizon's wholesale marketing organization. That wholesale marketing organization includes a stable of technical experts that testify for Verizon at state proceedings. In other words, competitors are forced to pay the salaries of the very people that fight against them in state proceedings when they want to try and provide service in Verizon's territory.

II. ELEMENTS OF EFFECTIVE MARKET OPENING

Although the Bells have resisted lower in the barriers to entry into their local markets, there have been a couple of successful market openings. These are the exceptions that prove the rule and indicate the direction that public policy should follow.

A. Success Stories

Although Verizon in New York resisted opening its local markets across its service territory, when regulators in New York and at the Department of Justice insisted on genuine market opening, Verizon was forced to comply. New York has proved different from other states' attempts at market opening because the New York Public Service Commission insisted on rigorous market opening conditions, implemented an effective performance assurance plan, provided detailed oversight over the process, and was committed to ensuring that pricing was fair.

As many other states, New York started out with high UNE prices, but the New York Commission made them interim in nature, when it became clear that the data the Commission had been given was faulty. It made the rates subject to refund and immediately instituted a new cost proceeding to address outstanding questions. As noted, an administrative law judge recently ordered a dramatic reduction in switching rates to bring them in line with other states like Illinois, Michigan and the Federal Communications Commission.

Although fewer residential/small business customers have switched to CLECs in Texas, the extensiveness of competition is strong. Texas switching rates have been low throughout. Loop rates are almost identical in the two states. It should be stressed that these markets were opened without raising basic service rates. New York is a “high” priced basic service state. Texas is a “low” priced basic service state. They were both able to open their markets without basic rate increase.

Consumers do not think the path to competition is to raise rates to attract competition in the hope that rates will come down at some time in the future. The consumer view is that incumbents should charge and new entrants should compete against efficient, forward-looking prices. We do not believe it is necessary to produce inefficient redundant facilities just for the sake of competition, especially when captive customers will bear the burden of that redundancy. If current deployment of distribution facilities (loop) is less expensive that new deployment of competing facilities, then those facilities should be made available at forward looking economic costs.

It also is a mistake to focus on basic service rates for competitive analysis, for one simple reason – competitors do not. When competitors determine whether to enter a market, they calculate the profit margin on all the services they are likely to sell to the customer, not just basic service.

When a competitor wins a customer (or the incumbent retains that customer), he will get not only the basic service revenue but also the federal subscriber line charge and any federal access revenues that the customer generates. The local service provider will also capture any revenues for vertical services (like call waiting or Caller ID) that the line is likely to generate. The competitor also is likely to capture intraLATA toll revenues. Many of the competitors also hope to capture the interLATA long distance business too. Most companies are also planning to capture Internet (high-speed data) revenues and some even have expressed interest in cable TV revenues. It is the total local bill against which the entrants are competing and the loop is used to provide all of these services.

B. New York-Style Competition

New York has been extremely successful compared to the rest of the country in fostering competitive entry into the local exchange market. Competition is much more intense in New York than elsewhere, with almost 20 percent of residential customers having switched. It has among the highest number of zip codes with six or more competitors. It has among the fewest zip codes that are not being served by a competitor. We believe that this is the model toward which all states should strive. Few have come even close. On a national average basis, competition for local residential service is about one-fifth the level of New York. Texas ranks second, with New York having a bout two and one-half times as many residential consumers who have switched. The competition in the local markets in the other states that are being touted by the Bells for entry is nowhere near as developed. For example, in California and Florida, the two most populous states awaiting entry, competitors have achieved only one-fifth the market share among residential customers as in New York.

After five years of finger pointing it is clear that the fundamental problem in the local market is a failure of incumbents to open their networks and regulators to set prices that will allow competition to gain a foothold (see Exhibit 1). Although New York has certain characteristics that make it an attractive market, it is not unique by any means. Many of the theoretically attractive characteristics that are found in New York are absent in Texas, which also has a much higher level of competition than the other large states we have examined.

New York has a relatively low percentage of residential lines, but so do Massachusetts, Pennsylvania, New Jersey and Maryland. It has a relatively low TELRIC cost, but so do Massachusetts, Illinois, California, Florida and New Jersey. Average household income is lower in New York than most other states under study. New York has relatively low intraLATA long distance usage, but relatively high interLATA usage. Nevertheless, several other state are close to or exceed New York on interLATA long distance usage, including Illinois, Ohio and Maryland.

Rather than blaming the competitors for not going to these states, where the telecommunications market is as attractive as in New York, the obstacles to competition lie in prices that are too high for unbundled network elements and operating support systems that do not treat competitors fairly. We conclude that there is no reason to believe that New York style competition could not be implemented in these other states. Not only would consumers save substantially on their telephone bills, but the potential base for a residential CLEC industry be much larger and stronger.

C. Consumer Savings in New York

As a result of genuine market opening in New York, new entrants offered statewide local rates at a substantial discount. One major competitor offered a statewide discount of at least five percent and when bought in combination with long distance (any plan) an additional $5 was taken off the bill. Given the rates in New York, this constituted an additional discount off the typical local bill of 10 to 15 percent. Customers, who want a bundled local and long distance company, could save between 15 and 20 percent off their local bill.[xxxvii]

In the long distance market, Verizon entered with a range of competitive offerings, anchored by an anytime, anywhere rate of $.10 per minute. Compared to the products in the market at the time, this was about a 50 percent savings for low volume customers. Other products offered by Verizon were attractive as well.[xxxviii]

As a result of genuinely open markets, consumers in New York have switched companies in droves (2.7 million local and 1.5 million long distance). Companies have engaged in "tit-for-tat" competition, matching each other's offers. Prices for both local and long distance service have dropped substantially (approximately 20 percent for those who shop).

D. Creating a Competitive Industry Would Benefit Consumers

Real market opening in New York has produced substantial benefits for consumers, but it is also critical to the development of a competitive local exchange carrier (CLEC) industry. Exhibit 2 shows a number of large states that have recently been mentioned as near-term

EXHIBIT 2
CHARACTERISTICS OF KEY STATES IN THE 271 PROCESS[xxxix]

	RESIDENTIAL & SMALL BUSINESS LINES (in thousands)			
TELRIC ($)	**ILEC**	**CLEC in**	**CLEC**	**Competitors'**

		LINES	Dec. 2000 (actual)	IF AT NY LEVEL (extrapolated)	Lines "missing" due to lack of NY-level competition (extrapolated)
VERIZON					
MA	17.33	2849	178	581	403
MD	18.52	2434	17	471	454
NJ	17.28	4521	74	882	808
PA	19.84	5853	339	1189	850
SBC					
CA	16.77	19,008	716	3786	3070
IL	17.10	5944	316	1202	886
OH	18.74	5617	69	1092	1023
MO	22.09	2997	39	583	544
BELLSOUTH					
FL	17.12	9587	222	1883	1661
GA	21.37	4339	198	871	673
QWEST					
AZ	17.94	2398	69	474	405
UT	18.33	869	33	173	140
WA	18.75	2952	87	583	496
TOTAL		**66,371**	**2357**	**13377**	**11412**
NY	16.31	7345	1745	1745	(actual)

SOURCE: FCC, Local Competition 2001.

candidates for RBOC requests for entry into long distance. These states, representing each of the regional bell operating companies, include 50 percent of all the residential lines in the country. In short, the future of the industry is in play. The difference between achieving a New York-level of competition compared to the current level of competition would be huge. Note that New York alone has almost as many CLEC residential lines as the other twelve, closed states combined.

If a New York-type outcome could be achieved in these other states, the residential CLEC industry would reach just over 13 million lines in these states, compared to just 2 million today. That is to say that because New York-level competition is absent in these populous states, about 11 million lines that should be in the hands of competitors are effectively "missing." Including New York, the residential CLEC industry in these states would consist of over fifteen million lines, compared to four million today. A fifteen million-line industry would have a substantial base for national residential competition.

If the approximately $6 per month saving on the total local bill were achieved by the additional customers won by CLECs in these states, consumer savings would be over $750 million per year (see Exhibit 3). Adding in long distance savings of $4 per month, would push the total to over $1.25 billion. As "tit-for-tat" competition spread to the whole local market, the total savings could rise to more than $7.5 billion. The larger states, like California would experience very large savings, $220 million in the local market gained by customers who switch and potentially over $2.25 billion as competition spreads across both local and long distance. Even in a smaller state like Washington, the local market savings for consumers who switch would be about $36 million and the total market impact could be over $350 million.

EXHIBIT 3: POTENTIAL CONSUMER SAVINGS FROM NEW YORK-STYLE COMPETITION

	CUSTOMERS WHO SWITCH			TOTAL MARKET TIT-FOR-TAT COMPETITION
	LOCAL (@ $6/month)	LONG DISTANCE (@4/MONTH)	TOTAL	
MA	$29.0	$19.3	$48.4	$341.9
MD	32.7	21.8	54.5	292.1
NJ	58.2	38.8	97.0	542.5
CA	221.0	147.4	368.4	2281.0
IL	63.8	42.5	106.3	713.3
OH	73.7	49.1	122.8	674.0
MO	39.2	26.1	65.3	359.6
FL	119.6	79.7	199.3	1150.4
GA	48.5	32.3	80.8	520.7
AZ	29.2	19.4	48.6	287.8
UT	10.1	6.7	16.8	104.3
WA	35.7	23.8	59.5	354.2

E. Competition Must Exist Before Allowing the Bells to Enter the Long Distance Market

Claims that competition can be promoted by just letting the Bells into the long distance market without properly opening their local markets do not pass close scrutiny. Two states —Connecticut and Hawaii— experienced early entry because the principal statewide incumbent was not a Bell. Connecticut is particularly interesting in this regard, since it borders New York. As the figures on the intensity, extensiveness, and balance of competition in Exhibit 1 indicate, the results for consumers with respect to local competition are disastrous. Connecticut is well below the national average for the amount of competition available to residential consumers. Hawaii, which is the second state that was not served by a Bell and had immediate long distance entry, has virtually no local competition.

The root cause of the success in New York is not the mere fact of entry by incumbents into long distance. The cause of the success in New York is the irreversible market opening that took place prior to allowing the company entry into long distance. Prematurely allowing incumbent local companies into the in-region long distance market undermines the prospects for competition. If the incumbents are allowed into long distance markets before their local markets are irreversibly open, local competition will not develop and long distance competition will not be vigorous. Bundling, or selling more than one telecommunications service to a particular customer (e.g. local and long distance) produces a much higher take rate for individual services and dramatically decreases churn rates, making it difficult for entrants to capture new customers. For example, Sprint long distance has a take rate of about 10% nationally. However, in regions where it sells local service, the take rates are approximately 40%. Similarly, when Southern New England Telephone entered the long distance market in Connecticut, it quickly captures about a 35 percent share of the residential market without offering prices that were more attractive than existing long distance competitors.[xl] It was the bundle of local and long distance that gave it the edge.

If the local market is not irreversibly open, only the incumbent can effectively offer the local/long distance bundle and that badly distorts competition. The incumbents can capture long distance customers without having to compete on price because barriers have not been removed. They face little real local competition and their hold is reinforced by their unique ability to offer a bundle of services. The risk that arises from a rush to approve 271 is that the incumbent can exploit the anticompetitive conditions, or "competitive imbalance," in the critical early days of the bundled telecommunications market. It can then rapidly capture long distance customers by bundling local and long distance service, while competitors are unable to respond with a competitively priced bundle.

F. The Important Role of State Public Utility Commissions

In addition to downplaying the importance of having competition well established before entry into long distance, the Bells have been attempting to pressure the states—principally via public utility commissions or PUCs—into supporting their applications for entry by downplaying the important role that the states play.

The state PUCs can use independent judgment and standards to decide whether to support an application for entry into long distance. The New York prefiling statement and collaborative process, which created the first and by far the most successful road map to §271 entry was developed largely without FCC input. Given the stunning success in New

York, it is certainly reasonable for the other state commissions to press for a model similar to New York.

In fact, the FCC has never approved an RBOC application without the support of the state utility commission. Although no RBOC has brought an application over the objection of the state, the Michigan application did not have the full support of the Commission, and it was rejected. Obviously, the state PUC must exercise reasonable judgment in determining whether an RBOC has opened its market to competition, but there is considerable leeway.[xli]

G. Conclusion

The clear — though unfortunately unusual — success of market opening in New York provides strong affirmation for the decision of Congress in the Telecommunications Act of 1996 to require not only that rigorous conditions to support local competition be in place before the Bells are allowed into the long distance market, but also that substantial competition be in place. The real world experience is consistent with common sense. A century old monopoly that continues to enjoy massive market power and crucial strategic assets will not easily, or willingly, relinquish its hold on the market.

Deregulating a dominant monopolist in the hopes of spurring competitors to enter the local phone market, when the competitors are at a severe competitive disadvantage, is not likely to lead to more competition. Rather, such a course is much more likely to lead to significant re-monopolization of both the local and long distance markets. Should that result, consumers will be denied the substantial benefits of a competitive market.

END NOTES

[i] The FCC took the opportunity of its first 271 decision to outline in detail the competitive advantage the local companies have in entering the long distance market compared to other companies entering the local market. The most crucial observation is to recognize, as the Antitrust court had, the power inherent in the incumbent monopoly status of the local exchange companies; Federal Communications Commission, Memorandum Opinion and Order In the Matter of Application by Ameritech Michigan to Section 271 of the Telecommunications Act of 1934, as amended, to Provide In-Region, InterLATA Service in Michigan, CC Docket 97-13, August 19, 1997 (hereafter FCC Michigan,) para 10).

> The court found that, if the BOCs were permitted to compete in the interexchange market, they would have "substantial incentives" and opportunity, through their control of local exchange and exchange access facilities and services, to discriminate against their interchange rivals and to cross subsidize their inter-exchange ventures...

These advantages include a history of legal barriers, economic and operational barriers, the fully deployed, ubiquitous network of the incumbents which lowers their incremental cost of entering other markets, and the need for interconnection. (FCC Michigan, paras. 11...12).

> For many years the provision of local exchange service was even more effectively cordoned off from competition then the long distance market. Regulators viewed local telecommunications markets as natural monopolies, and local telephone companies, the BOCs and other incumbent local exchange carriers, often held exclusive franchises to serve their territories. Moreover, even where competitors legally could enter local telecommunications markets, economic and operational barriers to entry effectively precluded such forays to any substantial degree...
>
> These economic and operational barriers largely are the result of the historical development of the local exchange markets and the economics of local networks. An incumbent LEC's ubiquitous network, financed over the years by the returns on investment under rate of return regulation, enables an incumbent LEC to serve new customers at a much lower incremental cost than a facilities based entrant that must install its own network components. Additionally, Congress recognized that duplicating the incumbents local networks on a ubiquitous scale would be enormously expensive. It also recognized that no competitor could provide a viable, broad-based local telecommunications service without inter-connecting with the incumbent LEC in order to complete calls to subscribers served by the incumbent LECs network.

[ii] In light of this structure of the Act, the Department of Justice (DOJ) succinctly summarized the public policy balance that Congress struck in the 1996 Act when it addressed the issue of RBOC entry into in-region long distance (Evaluation of the United States Department of Justice, Federal Communications Commission, In the Matter of Application of SBC Communications, Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc., d/b/a Southwestern Bell Long Distance for Provision of In-Region InterLATA Services in Oklahoma, CC Docket No. 97-121, May 16, 1997 (hereafter, DOJ, SBC), p. 4.:

> InterLATA markets remain highly concentrated and imperfectly competitive, however, and it is reasonable to conclude that additional entry, particularly by firms with the competitive assets of the BOCs, is likely to provide additional competitive benefits. But Section 271 reflects Congressional judgments about the importance of opening local telecommunications markets to competition as well. The incumbent local exchange carriers (LECs), broadly viewed, still have virtual monopolies in local exchange service and switched access, and dominate other local markets as well. Taken together, the BOCs have some three-quarters of all local revenues nationwide, and their revenues in their local markets are twice as large as the net interLATA market revenues in their service areas. Accordingly, more considerable benefits could be realized by fully opening the local market to competition.

[iii] DOJ, SBC, pp. 4-6.

> Section 271 reflects Congress' recognition that the BOCs' cooperation would be necessary, at least in the short run, to the development of meaningful local exchange competition, and that so long as a BOC continued to control local exchange markets, it would have the natural economic incentive to withhold such cooperation and to discriminate against it competitors. Accordingly, Congress conditioned BOC entry on completion of a variety of steps designed to facilitate entry and foster competition in local markets

[iv] The only facility mentioned in the Conference report on the Telecom Act was cable (see p. 148).

[v] The Consumer Federation of America has charted the unfolding failure of local competition at the national level and in a series of state-specific studies. See, Cooper, Mark N., *Last Chance for Local Competition: Policies to Open Markets Before Baby Bells Begin to Sell In-Region Long Distance Service* (June 17, 1997); *Affidavit of Mark N. Cooper on Behalf of the Consumer Federation of America*, before the Public Utility Commission of California R.93-04003, I.93-04-002, R.95-04043, R.85-04044, June 1998; Consumer Federation of America and Consumers Union, "Reply Comments," before the Federal Communications Commission, *In the Matter of Deployment of Wireline Services Offering Advanced Telecommunications Capability, Etc.*, CC Docket Nos. 98-147, 98-11, 98-26, 98-32, 98-78, 98-91, CCB/CPD Docket No. 98-15, RM 9244, October 18, 1998; The Consumer Stake in Vigorous Competition in the Illinois Local Telephone Market, March 1999). See also, Cooper, Mark, *Situation Report on Local Competition*

in New Jersey, November 1998. See also, comments filed by the Consumer Federation of America in "Reply Comments Of The Consumer Federation Of America," The Matter Of The Application By SBC Communications, Inc., For Authorization Under Section 271 Of The Telecommunications Act Of 1996 To Provide In-Region, Interlata Service In The State Of Missouri, Cc Docket No. 01-88 May 16, 2001: "Reply Comments Of The Consumer Federation Of America Massachusetts Consumer Coalition," before the Federal Communications Commission, *In the Matter of the Application by Verizon New England, Inc., for Authorization Under Section 271 of the Telecommunications Act of 1996 to Provide In Region, InterLATA Service in the State of Massachusetts,* CC Docket N. 01-9, February 28, 2001; "Comments Of The Consumer Federation Of America*, In the Matter of Application of SBC Communications Inc. and Southwestern Bell Telephone Company and Southwestern Bell Communications Services, Inc. D/B/A Southwestern Bell long Distance for Provision of In-Region, InterLATA Services in Texas*, Before the Federal Communications Commission, CC Docket No. 00-4, February 28, 2000; "Comments Of The Consumer Federation Of America," In the Matter of Application of New York Telephone Company (d/b/a/ Bell Atlantic – New York, Bell Atlantic Communications, Inc. NYNEX Long Distance Company and Bell Atlantic Global Networks, Inc., for Authorization To Provide In-Region, InterLATA Services in New York, Before the Federal Communications Commission, CC Docket No. 99-295, October 20, 1999;; "Reply Comments of the Consumer Federation of America," In the Matter of Application by BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services in Louisiana, Federal Communications Commission, CC Docket No. 97-231, December 19, 1997; "Reply Comments of the Consumer Federation of America," In the Matter of Application by BellSouth Corporation, et. al. For Provision of In-Region, InterLATA Services in South Carolina, Federal Communications Commission, CC Docket No. 97-208, November 14, 1997; "Comments of the Consumer Federation of America, before the Federal Communications Commission*, Memorandum Opinion and Order In the Matter of Application by Ameritech Michigan to Section 271 of the Telecommunications Act of 1934, as amended, to Provide In-Region, InterLATA Service in Michigan*, CC Docket 97-13, August 9, 1997 "Comments of Consumer Federation of America," before the Federal Communications Commission, In the Matter of the Local Competition Provisions of the Telecommunications Act of 1996, 1996.

[vi] Industry Analysis Division, Common Carrier Bureau, *Local Telephone Competition at the New Millennium* (Federal Communications Commission, December 2000) (hereafter, *Local Competition 2000,* p. 1.

[vii] Based on ratios in Industry Analysis Division, Common Carrier Bureau, *Local Competition: August 1999* (Federal Communications Commission, August 1999) (hereafter *Local Competition 1999),* which gives the most recent available data on residential versus business wire-to-wire competition.

[viii] Wigfield, Mark. "Rural Virginia Town Fights for Broadband Access," Dow Jones Newswires, June 7, 2001.

[ix] Reply Comments Of The Consumer Federation Of America, Consumers Union, And AARP, before The Federal Communications Commission, Proposed Transfer Of Control SBC And Ameritech, CC Docket No. 98-141, November 16, 1998); Citizen Action of Indiana, et al., *The Consumer Case Against the SBC-Ameritech Merger* (January 20, 1999).

[x] FCC, Statistics of Common Carriers, 1995/1996, Tables 1 and 2.5.

[xi] FCC, *Statistics of Common Carriers, 1998.1999, Tables 1 and 2.5,* adjusted for Bell Atlantic/GTE merger and CLEC line count.

[xii] The Cato Institute Daily Dispatch, February 7, 2001, reported the comment as follows,

> Clinton administration officials had maintained that many large telecommunications companies like the regional Bell operating companies should be deregulated only after their markets were sufficiently competitive, but Mr. Powell approached the subject from the opposite direction today.
>
> "I do not believe," he said, that "deregulation is like a dessert that you serve after people have fed on their vegetables and is a reward for the creation of competition. I believe that deregulation is instead a critical ingredient to facilitating competition, not something to be handed out after there is a substantial number of players in the market."

[xiii] The Tauzin Dingell bill would allow them into long distance in the data market without meeting the market opening conditions of section 271 of the Act.

[xiv] Conference Report on the Telecommunications Act of 1996, No. 104-458, p. 1.

[xv] DOJ, Michigan, pp. 32-33.

[xvi] FCC Michigan, paras 15...18.

[xvii] FCC Michigan, para 14.

> A salient feature of these market opening provisions is that a competitor's success in capturing local market share from the BOCs is dependent, to a significant degree, upon the BOCs' cooperation in the

non-discriminatory provision of interconnection, unbundled network elements and resold services pursuant to the pricing standards established in the statute. Because the BOCs, however, have little, if any, incentive to assist new entrant in their efforts to secure a share of the BOCs' markets, the Communications Act contains various measures to provide this incentive, including section 271. Through these statutory provisions, Congress required BOCs to demonstrate that they have opened their local telecommunications markets to competition before they are authorized to provide in-regions long distance services. Section 271 creates a critically important incentive for BOCs to cooperate in introducing competition in their historically monopoly local telecommunications markets.

[xviii] DOJ, SBC, pp. 7-8.

Section 271 establishes four basic requirements for long distance entry. The first three such requirements -- satisfaction of Section 271 [c] (1) (A) (Track A) or Section 271 [c](1)(B)(Track B), the competitive check list, and Section 272 -- establish specific, minimum criteria that a BOC must satisfy in all cases before an application may be granted. In addition, Congress imposed a fourth requirement, calling for the exercise of discretion of the Department of Justice and the Commission. The Department is to perform competitive evaluation of the application. "Using any standard the Attorney General considers appropriate." And, in order to approve the application, the Commission must find that "the requested authorization is consisted with the public interest. In reaching its conclusion on a particular application, the Commission is required to give "substantial weight to the Attorney General's evaluation."

[xix] PSC Chairman Supports Conditions for Bell Atlantic's Entry into Long Distance and Irreversible Opening of the Local Telephone Market, April 6, 1998, p. 2; "Pre-filing Statement of Bell Atlantic – New York, In the Matter of Petition of New York Telephone Company for Approval of Its Statement of Generally Available Terms and Conditions Pursuant to Section 252 of the Telecommunications Act of 1996 and Draft Filing Petition for InterLATA Entry Pursuant to Section 271 of the Telecommunications Act of 1996, Case 97-C-027, State of New York Public Service Commission, April 6, 1996.

[xx] "Comments of Bell Atlantic – Pennsylvania, Inc.," In Re: Bell Atlantic - Pennsylvania Entry Into In-Region InterLATA Services Under Section 271 of the Telecommunications Act of 1996, Docket No. M-00960840, I-00980075, June 11, 1998.

[xxi] "State Regulators Tell Bell Atlantic-New Jersey to Share Market," The Record, Oct. 22, 1998.

[xxii] "Reply Comments of the Consumer Federation of America, Massachusetts. The decision to allow entry has been appealed by MCIWorldcom and the Massachusetts Attorney General.

[xxiii] "Recommended Decision, by Administrative Law Judge Joel A. Linsider," *Proceeding on Motion of the Commission to Examine New York Telephone's Rates for Unbundled Network Elements,* Case NO. 98-C-1357, May 16, 2001.

[xxiv] June 6, 2001.

[xxv] Cooper, Mark, "Picking Up the Public Policy Pieces of Failed Business and Regulatory Models," presented at *Setting The Telecommunications Agenda,* Columbia Institute For Tele-Information, (November 3, 2000).

[xxvi] Application for Consent to Transfer of Control of Licenses and Section 214 Authorization from Telecommunications, Inc., Transferor, to AT&T Corp., Transferee, Public Interest Statement, Federal Communications Commission, CS Docket No. 98-178; Application for Consent to Transfer of Control of Licenses and Section 214 Authorization from MediaOne Group, Inc., Transferor, to AT&T Corp., Transferee, Public Interest Statement, Federal Communications Commission, CS Docket No. 99-251.

[xxvii] This was always a dubious proposition, see Consumers Union, Consumer Federation of America and Media Access Project, *Breaking the Rules: AT&T's Attempt to Buy a National Monopoly in Cable TV and Broadband Internet Services* (August 17, 1999). AT&T's promise to deliver service to about half a million residential households, which it labored to try to keep constitutes less than one half of one percent of all households in the nation.

[xxviii] The local exchange companies recognized the difficulty that cable companies would have in providing telephone service. Bell Atlantic described the problems in detail in its aborted attempt to purchase TCI. (See Bell Atlantic's Request for an Expedited Waiver Relating to Out-of-Region Interexchange Services and Satellite Programming Transport, *United States of America v. Western Electric Company, Inc., and American Telephone and Telegraph Company*, Civil No. 82-0192 (HHG) January 20, 1994. The request consists of six parts, the request itself and five affidavits (Affidavits in Support of Bell Atlantic's Request for an Expedited Waiver Relating to Out-of-Region Interexchange Services and Satellite Programming Transport, January 20, 1994. Individual affidavits include Alfred E. Kahn and William E. Taylor; Gary S. Becker; Robert W. Crandall; Robert G. Harris; and Brian D. Oliver. Ironically, prior AT&T management apparently reached the same conclusion. However, current AT&T management confesses to being unaware of these analyses (Cauley, Leslie, "Armstrong's Vision of AT&T Cable Empire Unravels on the Ground," *Wall Street Journal,* October 18, 2000). At least one cable company has publicly admitted that it cannot pursue a typical telephone service (circuit switched telephony) and will have to try to provide Internet

telephony, although there are no guarantees when, or whether, this approach will be viable for basic telephone service (Comments of Joe Waz at Setting The Telecommunications Agenda, Columbia Institute For Tele-Information, November 3, 2000).

[xxix] It was always a dubious proposition. See Cooper Mark, *Expanding the Information Age in the 1990s: A Pragmatic Consumer Analysis (*Consumer Federation of America and American Association of Retired Persons, January 1999*); Developing the Information Age in the 1990s: A Pragmatic Consumer View* (Consumer Federation of America, June 8, 1992)

[xxx] Consumer Federation of America and Consumer Action, *Transforming the Information Superhighway into a Private Toll Road* (September 1999), looks at problems in both the cable TV and the telephone industries from the point of view of advanced services.

[xxxi] See Comments of the Consumer Federation of America, Lousiana.

[xxxii] Industry Analysis Division, *Trends in Telephone Service,* December 2000.

[xxxiii] Federal Communications Commission, *Trends in Telephone Service, 2000* (March 2000); Federal Communications Commission, *Statistics of Common Carriers* (various issues).

[xxxiv]DOJ, SBC, pp. 61-62.

[xxxv]DOJ, SBC, p. vii., p. 27.

[xxxvi] Dreazen, Yochi. "FCC Probes Incorrect Data in SBC Phone Bid," Wall Street Journal, June 15, 2001.

[xxxvii] Comments Of The Consumer Federation Of America, In the Matter of Application of New York Telephone Company (d/b/a/ Bell Atlantic – New York) Bell Atlantic Communications, Inc. NYNEX Long Distance Company and Bell Atlantic Global Networks, Inc., for Authorization To Provide In-Region, InterLATA Services in New York, Before the Federal Communications Commission CC Docket No. 99-295, November 8, 1999.

[xxxviii] The Telecommunications Research and Action Center, *A Study of Telephone Competition in New York*, September 6, 2000.

[xxxix]Source: Lines and CLEC penetration from Industry Analysis Division, Local Telephone Competition: Status as of June 30, 2000 (Federal Communications Commission, December 2000); TELRIC based on Hybrid Proxy Cost Model; In the Matter of Access Charge Reform, Price Cap, Performance Review for Local Exchange Carriers, Low Volume Long Distance Users, Federal-State Joint Board On Universal Service, Before The Federal Communications Commission, CC Docket Nos. 96-262, 94-1, 99-249, 96-45, Comments Of Texas Office Of Public Utility Counsel Consumer Federation Of America**,** Consumers Union, November 12, 1999.

[xl] See CFA, "Reply Comments, Louisiana."

[xli] The framework was substantially defined in the rejection of the first two applications, in addition to the earlier discussion of Michigan and Oklahoma, see including Michigan Public Service Commission, In the Matter of the Commission's Own Motion to Consider Ameritech Michigan's Compliance with the Competitive Check List in Section 271 of the Telecommunications Act of 1996, Case No. U-11104;Federal Communications Commission, In the Matter of Application by Ameritech Michigan to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Service in Michigan, CC Docket 97-1Oklahoma Corporation Commission, Cause NO. PUD 97-64) Federal Communications Commission, In the Matter of Application of SBC Communications, Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc., d/b/a Southwestern Bell Long Distance for Provision of In-Region InterLATA Services in Oklahoma, CC Docket No. 97-121.